

Letter of Findings: 02-20130400
Composite Return Withholding Tax
For the Years 2009, 2010, and 2011

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ISSUES

I. Composite Return Withholding Tax – Imposition.

Authority: IC § 6-3-4-13; IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Income Tax Information Bulletin 72 (September 2007).

Taxpayer, an S corporation which has two nonresident shareholders, protests the assessment of composite return withholding tax.

II. Tax Administration – Interest.

Authority: IC § 6-3-4-13; IC § 6-8.1-10-1.

Taxpayer protests the imposition of statutory interest.

III. Tax Administration – Negligence Penalty and Penalty for Failure to File Composite Return.

Authority: IC § 6-3-4-13; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty and an annual \$500 penalty for failure to file a composite return.

STATEMENT OF FACTS

Taxpayer, an Indiana company, operates a gas station/convenience store in Indiana. Taxpayer elects to file as an S Corporation for income tax purposes. Taxpayer has two nonresident shareholders who live outside of Indiana.

In 2012, the Indiana Department of Revenue ("Department") audited Taxpayer's business records for the 2009, 2010, and 2011 tax years ("Tax Years at Issue"). Pursuant to the audit, based on the best information available at the time of the audit, the Department determined that Taxpayer had additional sales, which resulted in additional income for the Tax Years at Issue. The Department determined that Taxpayer, as an S Corporation having two nonresident shareholders, is required to file Indiana composite returns and withhold the income on behalf of its nonresident shareholders. Taxpayer failed to do so. The Department's audit imposed additional composite return withholding tax, interest, a ten-percent penalty, and an annual \$500 penalty under IC § 6-8.1-10-2.1(h) for each year of the Tax Years at Issue.

Taxpayer protests the assessments. A hearing was held. This Letter of Findings addresses Taxpayer's protest of composite return withholding tax. Letter of Findings 04-20130258 addresses Taxpayer's protest of additional sales tax. Letter of Findings 03-20130399 addresses Taxpayer's protest of county income tax withholding on wages paid to its employees. Letter of Findings 01-20130403P addresses the issue of penalty assessed against Taxpayer for failure to withhold the income tax on behalf of its non-resident shareholders. Additional facts will be provided as necessary.

I. Composite Return Withholding Tax – Imposition.

DISCUSSION

The Department's audit imposed additional composite return withholding tax on the ground that Taxpayer had income from its retail sales and did not file its corporate composite returns remitting the tax. Taxpayer, to the contrary, argued that it is a flow-through entity and is not subject to the tax.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

IC § 6-3-4-13 (effective January 1, 2008) states:

(a) Every corporation which is exempt from tax under [IC 6-3](#) pursuant to [IC 6-3-2-2.8\(2\)](#) **shall**, at the time that it pays or credits amounts to any of its nonresident shareholders as dividends or as their share of the corporation's undistributed taxable income, **withhold the amount prescribed by the department**. Such corporation so paying or crediting any nonresident shareholder:

(1) **shall be liable to the state of Indiana for the payment of the tax required to be withheld under this section and shall not be liable to such shareholder for the amount withheld and paid over in compliance or intended compliance with this section; and**

(2) when the aggregate amount due under [IC 6-3](#) and [IC 6-3.5](#) exceeds one hundred fifty dollars (\$150) per quarter, then such corporation shall make return and payment to the department quarterly, on such dates

and in such manner as the department shall prescribe, of the amount of tax which, under [IC 6-3](#) and [IC 6-3.5](#), it is required to withhold.

(b) Every corporation **shall**, at the time of each payment made by it to the department pursuant to this section, **deliver to the department a return** upon such form as shall be prescribed by the department **showing the total amounts paid or credited to its nonresident shareholders, the amount withheld** in accordance with the provisions of this section, and such other information as the department may require.

Every corporation withholding as provided in this section shall furnish to its nonresident shareholders annually, but not later than the fifteenth day of the third month after the end of its taxable year, a record of the amount of tax withheld on behalf of such shareholders on forms to be prescribed by the department.

(c) All money withheld by a corporation, pursuant to this section, shall immediately upon being withheld be the money of the state of Indiana and every corporation which withholds any amount of money under the provisions of this section shall hold the same in trust for the state of Indiana and for payment thereof to the department in the manner and at the times provided in [IC 6-3](#). Any corporation may be required to post a surety bond in such sum as the department shall determine to be appropriate to protect the state of Indiana with respect to money withheld pursuant to this section.

(d) The provisions of [IC 6-8.1](#) relating to additions to tax in case of delinquency and penalties shall apply to corporations subject to the provisions of this section, and for these purposes any amount withheld, or required to be withheld and remitted to the department under this section, shall be considered to be the tax of the corporation, and with respect to such amount it shall be considered the taxpayer.

(e) Amounts withheld from payments or credits to a nonresident shareholder during any taxable year of the corporation in accordance with the provisions of this section shall be considered to be a part payment of the tax imposed on such nonresident shareholder for the shareholder's taxable year within or with which the corporation's taxable year ends. A return made by the corporation under subsection (b) shall be accepted by the department as evidence in favor of the nonresident shareholder of the amount so withheld from the shareholder's distributive share.

(f) This section shall in no way relieve any nonresident shareholder from the shareholder's obligation of filing a return or returns at the time required under [IC 6-3](#) or [IC 6-3.5](#), and any unpaid tax shall be paid at the time prescribed by section 5 of this chapter.

(g) Instead of the reporting periods required under subsection (a), the department may permit a corporation to file one (1) return and payment each year if the corporation pays or credits amounts to its nonresident shareholders only one (1) time each year. The withholding return and payment are due on or before the fifteenth day of the fourth month after the end of the taxable year of the corporation.

(h) If a distribution will be made with property other than money or a gain is realized without the payment of money, the corporation shall not release the property or credit the gain until it has funds sufficient to enable it to pay the tax required to be withheld under this section. If necessary, the corporation shall obtain such funds from the shareholders.

(i) If a corporation fails to withhold and pay any amount of tax required to be withheld under this section and thereafter the tax is paid by the shareholders, such amount of tax as paid by the shareholders shall not be collected from the corporation but it shall not be relieved from liability for interest or penalty otherwise due in respect to such failure to withhold under [IC 6-8.1-10](#).

(j) **A corporation described in subsection (a) shall file a composite adjusted gross income tax return on behalf of all nonresident shareholders.** The composite return must include each nonresident individual shareholder regardless of whether or not the nonresident individual shareholder has other Indiana source income.

(k) If a corporation described in subsection (a) does not include all nonresident shareholders in the composite return, the corporation is subject to the penalty imposed under [IC 6-8.1-10-2.1\(j\)](#).

(Emphasis added).

The Department's Income Tax Information Bulletin 72 (September 2007), 20071003 Ind. Reg. 045070632NR ("Information Bulletin 72"), further illustrates, in relevant part, as follows:

Effective for taxable years beginning after December 31, 2007, **an S corporation or partnership shall file a composite adjusted gross income tax return on behalf of all nonresident shareholders** or partners.

Due to the similar treatment of composite returns for corporations and partnerships, whenever this bulletin mentions "corporation" or "shareholder", it refers to the S corporation or partnership and the shareholder or partner, respectively. The individual nonresident shareholders will be relieved of the obligation to file an individual adjusted gross income tax return unless they have income from other Indiana sources. **(Emphasis added).**

The Department's Information Bulletin 72 further outlines the limitations and conditions which apply to shareholders included in the composite return as well as the "Composite Filing Procedures."

At the hearing, Taxpayer argued that it was not responsible for the additional tax because it is an S Corporation and its nonresident shareholders filed their own Indiana individual income tax returns. To support its protest, Taxpayer submitted a copy of the first page of 1120S for the 2011 tax year.

Upon review, however, the Department is not able to agree. Taxpayer's records demonstrate that it has two nonresident shareholders. Therefore, pursuant to the above mentioned statute, Taxpayer is required to file the Indiana composite tax returns and is required to withhold tax on the distributive share of the income it pays or credits its nonresident shareholders. In this instance, the Department's audit found that Taxpayer received income from the additional sales for the Tax Years at Issue. Taxpayer thus is required to withhold on that income pursuant to the above mentioned statute. Since Taxpayer did not do so, the Department properly assessed Taxpayer the composite return withholding tax as result of the additional sales.

Notably, Taxpayer protests the Department's sales tax assessment on its additional sales. Taxpayer provides additional documentation to support its protest and Letter of Findings 04-20130258 sustains Taxpayer's protest in part on one issue pertaining to exempt "food stamp sales." As a result, the Department may adjust Taxpayer's additional sales pending a supplemental audit review performed by the Department's Audit Division. Thus, Taxpayer's protest of the additional composite return withholding tax is sustained to the extent the Department adjusts Taxpayer's additional sales pursuant to Letter of Findings 04-20130258.

FINDING

Taxpayer's protest is sustained to the extent that the Department adjusts Taxpayer's additional sales pursuant to Letter of Findings 04-20130258. The Department will recalculate Taxpayer's additional composite return withholding tax to be consistent with the result of the supplemental audit.

II. Tax Administration – Interest.

DISCUSSION

Pursuant to IC § 6-3-4-13(i), the Department assessed interest on the tax liabilities. Taxpayer protests the imposition of interest.

IC § 6-8.1-10-1(a) provides, as follows:

If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on the person's return by the due date for the return or the payment, or incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.

Pursuant to IC § 6-8.1-10-1(e), the Department does not have the authority to waive the interest.

FINDING

Taxpayer's protest regarding the imposition of interest is respectfully denied.

III. Tax Administration – Negligence Penalty and Penalty for Failure to File Composite Return.

DISCUSSION

Pursuant to IC § 6-3-4-13(i), the Department imposed a ten percent negligence penalty. The Department also assessed Taxpayer an annual \$500 penalty for the Tax Years at Issue under IC § 6-3-4-13(k).

Taxpayer protests the imposition of the penalties.

A. Negligence Penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

[45 IAC 15-11-2](#)(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2](#)(c), in part, as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;

- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer did not provide sufficient documentation establishing that its failure to pay tax or timely remit tax was due to reasonable cause and not due to negligence.

B. Annual \$500 penalty.

IC § 6-3-4-13(k) states that if an S corporation "does not include all nonresident shareholders in the composite return, the corporation is subject to the penalty imposed under [IC 6-8.1-10-2.1\(j\)](#)."

IC § 6-8.1-10-2.1(j) further provides that

If a partnership or an S corporation fails to include all nonresidential individual partners or nonresidential individual shareholders in a composite return as required by [IC 6-3-4-12\(h\)](#) or [IC 6-3-4-13\(j\)](#), a penalty of five hundred dollars (\$500) per partnership or S corporation is imposed on the partnership or S corporation.

In this instance, Taxpayer did not provide sufficient documentation to support its protest of the \$500 penalty. Thus, the Department is not able to agree that Taxpayer met its burden of proof for penalty waiver.

FINDING

Taxpayer's protest on the imposition of both penalties is respectfully denied.

SUMMARY

For the reasons discussed above, Taxpayer's protest of Issue I is sustained to the extent that the Department adjusts Taxpayer's additional taxable sales pursuant to Letter of Findings 04-20130258. The Department will recalculate Taxpayer's additional composite return withholding tax to be consistent with the result of the supplemental audit. However, the remainder of Taxpayer's protest is respectfully denied.

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